



# Internal Audit Division

## Auditor-Controller-Treasurer-Tax Collector

Compliance Audit Report

# Transient Occupancy Tax Operator Collections & Remittances

For the Calendar Year Ended  
December 31, 2023

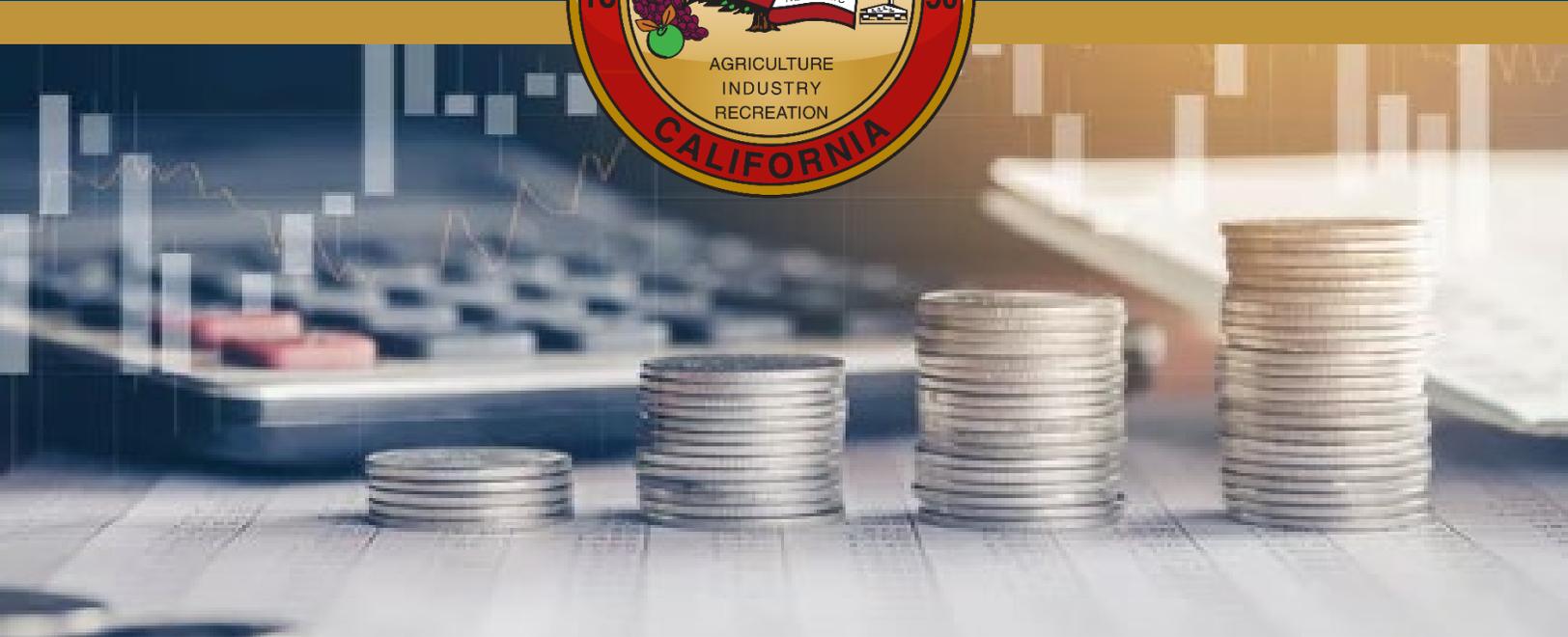
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## Executive Summary

The Audit Division of the Sonoma County Auditor-Controller-Treasurer-Tax Collector's Office (Internal Audit) completed a compliance audit of selected operators subject to the County's Transient Occupancy Tax (TOT) Ordinance.

For the period January 1 through December 31, 2023, we reviewed 6 property managers covering 10 properties. Key results are summarized below:

- **Filing Accuracy and Timeliness:** 4 of 10 properties filed timely TOT returns and provided records that supported amounts on their TOT returns; 6 properties provided records that did not agree with amounts reported on their TOT returns. All 10 reported gross rent based on check-in dates, rather than the date rent was collected, as required by the TOT Ordinance.
- **Underreported TOT:** TOT was underpaid by \$13,525, primarily due to the exclusion of \$80,625 in reservation processing fees from rent on returns.
- **Incorrect Tax Rate Applied:** One operator charged guests 15% TOT but remitted only 12% to the County.
- **Exclusion of Online Travel Companies' (OTC) Service Fees:** OTCs, including Airbnb and Vrbo, charge service fees, often 15% or more of gross rent. These fees are generally excluded from operator gross-rent reporting, resulting in lost TOT revenue.

### Summary of Recommendations

TOT Administration should:

- Settle identified underpayments with the respective Operators.
- Provide Beach Rentals and Sea Ranch Escapes Property Managers with information regarding taxable revenue requirements.
- Collaborate with County Counsel, the County Executive's Office, and the Board of Supervisors to evaluate the impact of SB 346 and update the TOT Ordinance or pursue alternative solutions to ensure OTC service fees are reported as taxable gross rent.

### Status of Prior Year Operator Audit Recommendations

- February 18, 2025, Report: 1 recommendation implemented; 1 is partially implemented; 2 are in process.
- December 15, 2023, Report: 1 recommendation implemented; 1 is partially implemented.

## Introduction

Internal Audit has completed a compliance audit of the collections and remittances of selected operators subject to the County's TOT Ordinance. The audit was conducted in accordance with Global Internal Audit Standards (Standards). These Standards require that we identify, analyze, evaluate, and document sufficient information and evidence to achieve our audit objectives. We believe the evidence obtained provides a reasonable basis for the results presented in this report.

The purpose of this report is to provide management with independent and objective analyses, recommendations, and other information concerning the activities reviewed. The audit report is a tool to help management identify and implement improvements.

From time to time, management may request that Internal Audit perform studies or audits to support risk management needs. When responding to such requests, Internal Audit does not assume responsibility for the design, implementation, or operations of internal controls, thereby maintaining its independence.

At the request of the County Executive's Office, Internal Audit conducts periodic audits of TOT operators. For purposes of this audit, TOT Administration is performed by the Revenue Accounting Division of the Auditor-Controller-Treasurer-Tax Collector. The revenue Accounting Division and the Internal Audit Division both report to the Auditor-Controller-Treasurer-Tax Collector. Internal Audit analyzes TOT data and proposes the audit scope, which is then agreed upon with TOT Administration. We do not believe that performing this audit constitutes assuming responsibility for the design, implementation, or operation of any part of TOT Administration's internal control system.

## Background

California Revenue and Taxation Code Section 7280 authorizes counties to levy Transient Occupancy Tax (TOT) as an additional source of non-property tax revenue. TOT is charged to transients who occupy lodging facilities, including hotels, motels, campgrounds, and vacation rentals, in the unincorporated areas of the County for fewer than 30 consecutive calendar days. For the audit period, the County's TOT rate was 12%. TOT revenue is discretionary and may be used for any lawful County purpose.

As of December 31, 2023, the County had 2,746 active registered operators, including traditional lodging establishments, recreational parks, campgrounds, vacation rentals, and property management firms. Total TOT collections for calendar year 2023 were \$30.0 million, compared to \$33.1 million in 2022.

For bookings made through Airbnb, the platform collects, reports and remits TOT in aggregate for hosts located in unincorporated Sonoma County. TOT Administration is responsible for administering and enforcing TOT requirements and works with Permit Sonoma to ensure that all permitted vacation rentals obtain a TOT certificate. Operators are required to file TOT tax returns and remit tax on a quarterly basis, or more frequently if directed by TOT Administration.

## Objective

The primary objective of this audit was to determine whether the selected individuals and businesses involved in short-term rentals filed timely and accurate TOT returns and remitted the correct amounts due in accordance with the financial provisions of the County's TOT Ordinance.

## Scope

The audit covered the period January 1 through December 31, 2023, and included 6 property managers managing 10 properties. These properties reported approximately \$5.6 million in taxable receipts and paid \$0.6 million in TOT during the audit period. We also followed up on prior-year recommendations with TOT Administration.

The audited properties reported \$57,790 in Airbnb gross rent exemptions. We were unable to verify these amounts because Airbnb does not provide detailed records when remitting TOT.

## Methodology

We reviewed and analyzed 2023 TOT collections by performing a trend analysis of all properties managed by property managers. We judgmentally selected a sample of 10 establishments and reviewed the following documentation.

- Property Management revenue statements
- Sample of guest invoices/folios
- Guest registry or financial system reports of rent collected
- Online travel company revenue statements
- Contracts and other supporting documentation for exempt stays

Using records obtained from establishments, we calculated taxable amounts and compared them with reported amounts on TOT returns. Results were discussed with operators' management and are presented in the Results and Other Matters sections of this report.

## Results

Of the 10 properties reviewed, 4 properties managed by 2 property managers filed timely TOT returns which were supported by operator provided records. All 10 properties reviewed reported gross rent based on check-in date instead of the date that rent was collected from transients, as required by Sec. 12-15 of the TOT Ordinance. This issue has been included in an audit finding and recommendation for the audit report dated February 18, 2025.

The remaining 6 properties managed by 4 property managers had one or more instances of non-compliance. In several cases, reported amounts were not supported by records provided during the audit.

Due to non-compliance identified with 2 property managers, we expanded our procedures to include all properties they manage. 107 properties underpaid TOT by a combined \$13,525, primarily due to the exclusion of service fees from gross rent.

Below are the detailed results for each property manager with one or more exceptions.

### **Property Manager: Beach Rentals**

Horizon Reach - TOT underpaid by \$122 due to the exclusion of \$1,015 in reservation processing fees from gross rent.

Wild Iris - TOT underpaid by \$101 due to the exclusion of \$840 in reservation processing fees from gross rent.

We expanded our review to all Beach Rentals properties. In total, reservation processing fees of \$42,910 were excluded from gross rent resulting in underpaid TOT of \$5,149.

Beach Rentals charges reservation processing fees to transients but does not collect or remit TOT on these fees, contrary to the requirements of the TOT Ordinance.

### **Property Manager: Sea Ranch Escapes**

Autumn Mist - TOT underpaid by \$187 due to the exclusion of \$1,560 in reservation processing fees from gross rent.

Masthead Dunes - TOT underpaid by \$168 due to the exclusion of \$1,400 in reservation processing fees from gross rent.

We expanded our review to all Sea Ranch Escapes properties. In total, reservation processing fees of \$37,720 were excluded from gross rent resulting in underpaid TOT of \$4,526.

Sea Ranch Escapes charges reservation processing fees to transients but does not collect or remit TOT on these fees, contrary to the requirements of the TOT Ordinance.

### **Property Manager: Beth Degolia**

Aftermath - TOT underpaid by \$418 because gross rent reported on TOT returns was \$3,486 lower than gross rent calculated from Vrbo Payout Summary Reports.

**Property Manager: Sandy Atwood**

Casa Estrella - TOT underpaid by at least \$3,432 for several reasons:

- Reservations booked through Vrbo charged guests 15% TOT, only 12% was remitted to the County.
- Gross rent reported in TOT returns was not supported by documentation.
- The property manager improperly deducted Vrbo fees from gross rent and reported net payout instead of gross rent as required.

## Other Matters

**Loss of TOT Revenue Related to OTC Service Fees:**

The County has been losing approximately \$1.5 million or more in TOT revenue because several Online Travel Companies (OTCs) do not include mandatory service fees in the taxable gross rent calculation. OTC fees often equal 15% or more of the rental amount charged to transients, yet TOT is not collected or remitted on these fees by some platforms. This creates an unequal operating environment for operators who do include such fees in their taxable gross rent.

On July 9, 2024, the County Executive's Office, Auditor-Controller-Treasurer-Tax Collector, and County Counsel presented a proposed update to the TOT Ordinance to the Board of Supervisors. The update would have clarified that entities facilitating the rental of accommodations, such as OTCs, are considered "operators" and therefore required to collect and remit TOT on service fees. The proposal did not receive the necessary votes to proceed.

**Recent Legislative and Platform Changes:**

California enacted SB 346, effective January 1, 2026, which will require short-term rental platforms (including Airbnb and Vrbo) to share specific host and property data with local governments. The impact of this data-sharing requirement on TOT administration and collections is not yet known.

Airbnb has also announced changes to its fee structure. Effective October 27, 2025, Airbnb will deduct a 15.5% service fee from host payouts rather than separately charging guests a service fee. The effect of this change on TOT collections is uncertain. For periods after October 27, 2025, the issue of TOT not being collected on Airbnb service fees may be partially or totally resolved. Entities that collect and pay TOT on services fees will be at a disadvantage compared to OTC's that charge services fess and don't remit TOT, and the County will continue to lose approximately \$677,000 or more in TOT revenue until the TOT Ordinance is updated.

Until the TOT Ordinance is updated to address OTC service fees, operators who collect and remit TOT on such fees will remain at a competitive disadvantage, and the County will continue to experience significant TOT revenue loss related to non-remitted TOT on service fees.

## Recommendations & Management Responses

The following recommendations are offered for improvement. All recommendations are classified as Priority 4 (Opportunity for Improvement).

### **Recommendation No. 1 – Settle Underpaid TOT (Priority 4)**

TOT Administration should work with the respective operators to settle the identified underpayments of TOT.

#### **Management Response:**

The TOT Administration will review the underpayment calculations. If TOT Administration agrees with the findings, letters will be sent to the audited establishments informing the operators of the audit findings and requesting additional funds.

### **Recommendation No. 2 – Clarify Taxability of Reservation Processing Fees (Priority 4):**

TOT Administration should notify Beach Rentals and Sea Ranch Escapes that reservation processing fees are taxable and must be included in gross rent reported on TOT returns.

#### **Management Response:**

The TOT Administration is aware of this matter and is addressing it appropriately.

### **Recommendation No. 3 – Evaluate Impacts of SB 346 and Update TOT Ordinance (Priority 4):**

The County Executive's Office, Auditor-Controller-Treasurer-Tax Collector, and County Counsel should evaluate the impacts of SB 346 and determine whether updates to the TOT Ordinance, or alternative administrative solutions, are needed to ensure that all operators, including Online Travel Companies (OTCs), report taxable service fees as gross rent and remit TOT on those fees.

#### **Management Response:**

The TOT Administration agrees with your recommendation and have already had initial discussions with County Counsel and the Chief Executive Office. We will continue to explore the best approach on timing of the updates.

## Status of Prior Audit Report Recommendations

### Recommendations from Audit Report Dated February 18, 2025

#### Recommendation No. 1 (Priority 2):

Underpaid TOT and BIA should be settled with respective operators as appropriate.

#### Status No. 1: In Process

The TOT Administration continues to work on settling unpaid balances for 1 property manager and 1 operator.

#### Recommendation No. 2 (Priority 2):

TOT Administration should implement a process to monitor owner/operator compliance with the financial provisions of the Condition 91 Fee Agreement and other similar agreements or special arrangements between the County and entities.

#### Status No. 2: Implemented

TOT Administration confirmed that Ratna Ling is the only establishment operating under a Condition 91 Fee Agreement with the County. TOT Administration has implemented an annual reminder to Ratna Ling, requesting verification of any room-rate increases tied to the annual CPI adjustment.

#### Recommendation No. 3 (Priority 2):

The TOT Administration should remove the language from the Airbnb and Vrbo Reporting Instructions which states "TOT should be reported when the stay occurs". TOT Administration should communicate with all operators the requirement in Sec. 12-15 of the TOT Ordinance for operators to report and remit gross rents and TOT based on when rents are charged, received and the amount of TOT is collected for transient occupancies. The communication should give operators time to change their reporting and make it clear that reporting using other criteria such as check-in date is not an acceptable basis of reporting rents and TOT.

#### Status No. 3: In Process

The TOT Administration continues to evaluate options for the audit-recommended communication. Management is closely evaluating ongoing impacts related to recent changes to the Voluntary Collection Agreements (VCAs), as well as pending legislation that may materially impact current processes.

#### Recommendation No. 4 (Priority 2):

TOT Administration should consider taking steps outlined in the ordinance, including revoking their TOT certificate, to compel Elder Properties to provide records supporting TOT returns, as required by the TOT Ordinance.

**Status No. 4: Partially Implemented**

Elder Properties was unable to provide the complete documentation required to conduct and complete the audit for calendar year 2022. TOT Administration stated that from June 2023, Elder Properties have started submitting their Vrbo and Airbnb statements along with their TOT returns to TOT Administration. The 2022 audit could not be completed, as a result there remains an ongoing risk that TOT remittances for that year may have been under reported to the County.

**Recommendations from Report Dated December 15, 2023****Recommendation No. 2 (Priority 4):**

TOT Administration should review the exemption treatment for Hilton Garden Inn in accordance with the TOT Ordinance and provide guidance to ensure consistent application of the exemption rule. TOT Administration should prescribe appropriate documents to support exemptions reported by the establishment.

**Status No. 2: Implemented**

TOT Administration reached out to Hilton Garden Inn who confirmed that they no longer have tax-exempt accounts.

**Recommendation No. 4 (Priority 4):**

For those entities that failed to provide requested TOT records as required by the TOT Ordinance, TOT Administration should consider taking steps outlined in the ordinance to compel the operators to provide records, including revoking their TOT certificate.

**Status No. 4: Partially Implemented**

TOT Administration stated that both short-term rental operations are closed. 1 property is now owner occupied, and TOT Administration is waiting on a closure form for the TOT certificate. The second property reopened under new ownership.

## Priority Ratings and Definitions

Priority Ratings	Definition of Priority Ratings and Suggested Implementation Timeframe
High / Priority 1	<p>Priority 1 recommendations are assigned to the highest assessed level of risk. For these recommendations, internal controls are considered poor or insufficient, which results in the likelihood of financial loss, waste, misappropriation of assets, or errors for the area(s) evaluated. Priority One recommendations also include issues related to non-compliance with laws, regulations or policies and procedures.</p> <p>Management should urgently implement these recommendations within one to three months after issuance of the final audit report to avoid risk exposure.</p>
Medium / Priority 2	<p>Priority 2 recommendations are assigned to the moderately assessed level of risk. For these recommendations, internal controls provide reasonable assurance that the County program(s) or area(s) evaluated are protected from potential financial loss, waste, misappropriation of assets, or errors; however, additional action is needed to strengthen current practices.</p> <p>Management should promptly implement these recommendations within three to six months after issuance of the final audit report to improve internal control processes.</p>
Low / Priority 3	<p>Priority 3 recommendations are assigned to the lowest assessed level of risk. For these recommendations, internal controls are operating as designed to ensure the County program(s) or area(s) evaluated are protected from potential financial loss, waste, misappropriation of assets, or errors. These recommendations are desired actions to enhance current practices.</p> <p>Management should consider implementing these recommendations within six to 12 months after issuance of the final audit report to provide additional confidence in the internal control system.</p>
Opportunity for improvement/ Priority 4	<p>Priority 4 recommendations are assigned to matters which do not involve internal controls, they typically involve opportunities for improvement or efficiency/effectiveness issues that require management's consideration to implement or enhance processes.</p>